



Rob McKenna

ATTORNEY GENERAL OF WASHINGTON

P.O. Box 2317 (1019 Pacific Ave-3rd Fl) • Tacoma WA 98401-2317

June 6, 2006

The Honorable Karen Keiser
Washington State Senate
P.O. Box 40433
Olympia, Washington 98504-0433

Re: **Gasoline Prices**
CCTN #71957

Dear Senator Keiser:

Attorney General Rob McKenna has asked me to respond to your letter of April 26, 2006. In your letter you point out that recent increases in Washington gasoline prices exceed the U.S. average. You find this fact problematic for two reasons. One, you point out that our state receives substantial quantities of crude from Alaska. Two, you note that Washington has substantial refining capacity. In your view, these two factors should result in lower transportation costs for Washington and these lower costs should be reflected in lower prices or at least smaller price increases. You point out that the price increase in Idaho during the first three months of this year was approximately half that in Washington. And finally, you assert that the changeover to fuels without MTBE's, cited by the federal government as a factor in price increases, is "not a factor in Washington State."

The Attorney General shares your concerns over the high price of gasoline generally, as well as price differentials between the price of gasoline in Washington and the price in neighboring states. He stands ready to do all within the power granted him by statute and the Washington Constitution to vigorously pursue anyone who violates the law. We in the Washington Attorney General's Office are experiencing the same pinch on our household budgets as are the rest of our fellow Washingtonians. We have all built our lives to a great extent around the existing cost of energy and when those costs rise quickly and substantially, they force us to make painful economic adjustments. Because of the most recent run-up of prices to record levels, there has been considerable public outcry and an understandable demand for an explanation of the causes of the increase.

The starting point for any discussion of gasoline prices is to note that gasoline is an unregulated commodity at both the wholesale and the retail level. No government agency has the power to dictate what the oil companies, jobbers or local gas stations may charge for gasoline. No law

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requires that gasoline prices be low or reasonable or just. This means, under both state and federal law, oil companies and gas station operators may charge whatever price the market will bear.

In addition, Washington has not enacted a "price gouging" statute as a number of states have. This means we have no special authority to investigate high prices, *per se*. Whether a price gouging statute would be effective is another matter. These statutes typically are designed to rein in prices during emergencies, such as natural disasters. In addition, recent press accounts suggest price gouging statutes may not be the solution to generally rising market prices. An article in the May 10 *San Francisco Chronicle* on-line edition reports that the California Attorney General's Office selected approximately 50 complaints from among the 1,050 they had received, then interviewed the station owners and examined their books. They did not find a single violation of state or federal law. All the gas station owners were able to prove was that their costs rose as fast or even faster than their prices. I am not aware of any state price gouging enforcement efforts involving refiners, but I expect those efforts would face similar proof difficulties.

By not regulating gasoline prices, both the Legislature and the Congress have left prices to be set by the interaction of buyers and sellers in a free market rather than by government officials. This is how most, if not all, commodity prices are determined in our economy. Given that fact and in the absence of price regulation or a price gouging statute, the Attorney General's role in gasoline pricing is limited to protecting the integrity of the marketplace through enforcement of the Consumer Protection Act, including its antitrust provisions.¹ The CPA prohibits: 1) unfair or deceptive acts or practices, 2) contracts, combinations and conspiracies in restraint of trade, and 3) anticompetitive mergers, monopolistic practices and other exclusionary unilateral practices. Attorney General McKenna is ready, willing and able to vigorously enforce these provisions whenever evidence of a violation sufficient to support enforcement exists.

No doubt many Washingtonians consider the existing price differential between Washington and other states to be intrinsically unfair. I share their frustration in that regard. Statutory and case law, however, dictate that in order for an unfair practice to be illegal under the CPA, we must prove three things:

1. The practice offends public policy as set out in statutes, the common law or otherwise.
2. The practice is immoral, unethical, oppressive or unscrupulous.
3. It causes substantial injury to consumers or to competition.

In the long experience of this office in bringing cases under the CPA, proving the first two of these elements based upon price differential alone is problematic, at best. At the very least, it

¹ The Attorney General also has what is known as *parens patriae* authority to enforce federal antitrust laws. Because the substantive provisions of federal antitrust law are so similar to Washington law on the subject, I have not discussed federal law separately.

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would require a price level substantially higher than what we have seen to date or area price differentials several times greater than presently exist.

Collusion among competitors in setting prices violates the antitrust provisions of the CPA. There have been many investigations by state governments and the Federal Trade Commission in the past several years and none has uncovered evidence of collusion. Nevertheless, we take the antitrust laws seriously and would thoroughly investigate any credible allegation of collusion. If you are aware of anyone with knowledge of specific allegations or suspicions that collusion is occurring, please have them immediately contact our Antitrust Division at (206) 464-7352.

In addition to prohibiting collusion among competitors, the antitrust laws also prohibit anticompetitive mergers, monopolistic practices and other exclusionary unilateral practices. This office has long played an active role in reviewing petroleum industry mergers and acquisitions. Most recently, the Antitrust Division reviewed the ConocoPhillips merger in 2002. In that case, the Attorney General required ConocoPhillips to sell its Spokane terminal as a condition of approving the merger.²

The Federal Trade Commission recently released the report of its extensive investigation into post-Katrina gasoline price increases and allegations of price manipulation.³ The study looked at the refining industry, the supply distribution infrastructure, product inventory practices as well as a number of other practices involving potential manipulation of gasoline prices. The FTC found no instances of illegal market manipulation leading to higher prices. It did find a small number of instances of pricing at the refining, wholesale and retail level that fit the definition of price gouging as defined by Congress in the Commission's FY 2006 appropriation. However, the report went on to conclude that other factors such as regional and local market trends appeared to explain the prices in nearly all cases. The report also reiterated the Commission's view that gasoline price gouging legislation would be difficult to enforce and cause more problems for consumers than it solves. Competitive market forces, the report says, should be allowed to determine the price of gasoline drivers pay at the pump.

An unexplained price differential, without more, is probably insufficient to invoke the Attorney General's investigative power under the CPA. In the absence of evidence of illegal conduct then, any examination of price differentials is the province of economists. As you may know, a comprehensive study of the Washington gasoline market was last conducted about 16 years ago by analysts with the state energy office (now the Energy Policy Division within the Department of Community, Trade and Economic Development).⁴ The study concluded that eight factors explained 80 percent of the price differential. These include:

- The cost of transporting gasoline from refineries to stations.

² More information about the Attorney General's merger enforcement activity is available on the Attorney General's web site, <http://www.atg.wa.gov/consumer/gasprices/report.shtml>.

³ A summary of the report's findings and a copy of the entire report are available on the FTC website, <http://www.ftc.gov/opa/2006/05/katrinagasprices.htm>. Price manipulation is illegal if it can be shown to be a monopolistic or other exclusionary unilateral practice.

⁴ Mark Anderson, Brian Lagerberg and Dick Byers, Washington State Energy Office, "Washington State Gasoline Prices Study" (July 1991).

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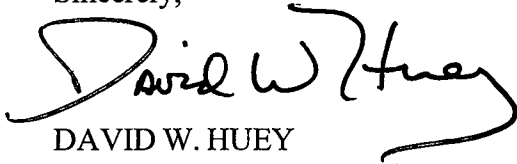
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- Market demand for gasoline, measured as vehicles per square mile.
- Proximity (i.e., within 30 miles) to the Canadian border.
- Dealer margins.
- Whether or not a station offers discounts for cash.
- Whether a dealer is supplied directly from the refiner or from a distributor.
- Average wholesale price.

It may be appropriate for that study to be updated, using current market data. Such a study would likely go a long way towards explaining the price differences outlined in your letter. Our office would be happy to join you, if you wish, in suggesting to the Legislature that they fund such a study, either within the Energy Policy Division or by contracting with economists at either the University of Washington or Washington State University. In addition to supporting such a proposal, we would be glad to work with you to ensure it is objective and scientifically valid.

Again, I appreciate the opportunity to respond to your concerns. Please feel free to contact me if you have any other questions and to discuss your potential interest in an updated economic study.

Sincerely,

A handwritten signature in black ink, appearing to read "David W. Huey". The signature is fluid and cursive, with a large, sweeping initial "D".

DAVID W. HUEY
Assistant Attorney General
Consumer Protection Division
(253) 593-5057

DWH:bn

cc: Rob McKenna, Attorney General
Milt Doumit, Acting Chief Deputy Attorney General
Nancy Hovis, Deputy Attorney General